STATE OF MICHIGAN
IN THE CIRCUIT COURT FOR THE 30TH JUDICIAL CIRCUIT
INGHAM COUNTY

KEN ROSS, COMMISSIONER OF THE OFFICE OF FINANCIAL AND INSURANCE REGULATION,

Petitioner,

vs.

AMERICAN COMMUNITY MUTUAL INSURANCE COMPANY,

Respondent.

Case No. 10-397-CR
Hon. William E. Collette

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FORMER OFFICERS' BRIEF IN RESPONSE TO TRAPEZA'S BRIEF IN SUPPORT OF REHABILITATOR'S DENIAL OF FORMER OFFICERS' CLAIMS TO SEVERANCE AND OTHER BENEFITS UNDER PRE-REHABILITATION EXECUTIVE EMPLOYMENT AGREEMENTS

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INTRODUCTION

The facts leading up to the entry of the Stipulated Order Placing American Community Mutual Insurance Company Into Rehabilitation, Approving Appointment and Compensation of Special Deputy Rehabilitators, and Providing Injunctive Relief are set forth in detail in the Brief in Support of Former Officers' Claims for Severance and/or Other Benefits Pursuant to the Terms of Their Executive Employment Agreements. They are herein incorporated by reference.

As did the Attorney General, these Surplus Noteholders, Trapeza CDO IX and Trapeza CDO X (jointly "Trapeza") spend a good deal of space attacking the Former Officers ("Petitioners") without a single fact to support the disparagement. As with the argument of the Attorney General, truly the facts regarding any of these Petitioners' tenure with American Community is irrelevant. Not a one was discharged for "Cause." Five of the six were not only retained by the Rehabilitator after the Rehabilitation was commenced, they were induced to stay with offers of retention bonuses (albeit Downey was only for a short time before being terminated without cause).

Of course, one who lives in a glass investment house should know better than to cast disparagements. The term CDO stands for Collateralize Debt Obligations. CDOs are those nifty little creations of the financial world which provided the jet fuel for the crash of the economy in 2008. See Exhibit 1. These particular Collateralize Debt Obligation companies are based in the Caymen Islands and each contain hundreds of millions of dollars worth of debt obligation which was cut up and sold in tranches, much of which on their own would have no more than junk investment value, but, magically, through securitization they were given the highest investment imprimaturs by the various rating houses. Thus, the attempt to portray these Surplus Noteholders somehow as victims, if the Petitioners are compensated for the services they rendered over the years to American Community, is laughable. Additionally, Trapeza purchased the Note from Credit Suisse and it must be assumed that the purchase was at a substantial discount from face value.

Clearly, sophisticated investors purchased this Note which comprised a minuscule portion of the entire investment. And, as Trapeza acknowledges, the Note was purchased with full knowledge that it held a class 8 priority. The only priority below class 8 under the applicable statute is shareholders and, this being a mutual insurance company, there are no shareholders. In other words, Trapeza knew that in the event of a liquidation, it was going to be the last to feed at the trough.

ARGUMENT

I. The Petitioners' claims are higher in priority than the Surplus Noteholders.

Trapeza's arguments for the most part parrots those of the Attorney General and those arguments have been thoroughly addressed in the Petitioners' Response to that Brief. However, some aspects of the argument merit Petitioners' brief response.

Trapeza cites blackletter law regarding interpretation of statutes and then ignores it. The first rule is set forth in City of Romulus v Michigan Department of Environment Quality, 260 Mich App 54, 65 (2003). ". . .If the language is unambiguous on its face, the drafter is presumed to have intended the meaning plainly expressed and further judicial interpretation is not permitted." MCLA 500.8142 is clear and unambiguous. Claims of surplus noteholders are a Class 8 priority, claims of general creditors are Class 5 priorities, and any other claim other than Class 8 or Class 9 (claims of shareholders and owners) are Class 7. Thus, regardless of whether the Petitioner's claims are categorized as Class 5 or Class 7, they are higher and superior to those of Trapeza.

Next, Trapeza makes the same mistake as the Attorney General, by ignoring long established Michigan law and concluding incorrectly that these claims are not based upon prior services rendered. The argument that the benefits sought by the Petitioners are in return for prior services rendered bears repeating, because it so clear and elementary.

As the Federal District Court explained in Holland v Graves Publishing, 46 F. Supp. 2d 681:

> "Corbin on Contracts sets forth the following discussion of unilateral contracts with regard to bonus programs offered by employers, which is particularly relevant in this case.
>
> > **The same unilateral contract analysis is applicable to the employer's promise to pay a bonus or pension to an employee in case the latter continues to serve for a stated period.** It is now recognized that ***these are not pure gratuities but compensation for services rendered.*** The employer's promise is not enforceable when made, but the employee can accept the offer by continuing to serve as requested, even though the employee makes no promise ***There is no mutuality of obligation, but there is consideration in the form of service rendered. The employee's one consideration, rendition of services, supports all of the employer's promises, to pay the salary and to pay the bonus***. Indeed, although the bonus is not fully earned until the service has continued for the full time, after a substantial part of the service has been rendered the offer of the bonus cannot be withdrawn without a breach of contract.
>
> 2 Corbin, Contracts § 6.2 (rev. ed. 1995)." Supra, pp. 685-686 [Emphasis added.]

A. The express provisions of Chapter 81 do not disallow the Petitioners' claims.

The consideration for the Change in Control benefit and/or severance is the services which the Petitioners rendered between the time the Executive Employment Agreements were executed and the time the Rehabilitation was ordered. Trapeza's brazen declaration that, "The Legislature has plainly stated that there is no right for former officers, who were at the helm of the sinking ship, to recover anything other than the *hours worked* prior to the issuance of the order. . ." is just that, a brazen statement without basis. Clearly, had the legislature wanted to plainly state that former officers could only recover wages for hours worked, it surely could have said just that. Instead, it couched the language consistent with recognized contract law as referenced above, and in greater detail in Petitioners' Response to the Attorney General's Brief.

Finally, Trapeza confuses the prioritizing of claims with the allowance of claims. MCLA 500.8142(1)(a)(vii) provides a Class 1 priority to "Debts[1] due to employees for services performed to the extent that they do not exceed $1,000.00 . . . if the court determines that the payments are reasonably necessary to an orderly and effective administration for the protection of class 2 claimants." And, MCLA 500.8142(1)(d) provides a Class 4 priority to the identical claims, except where they have not been found to be reasonable and necessary for the administration. Although officers are specifically excluded from this priority, there is nothing which states such claims are barred. If that were the case, not only officers, but also no employees, regardless of their status, would have any claim, for wages or otherwise which exceed $1,000.00. Clearly, such is not the case.

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[1]Note the statute is careful not to limit the claims to only wages due for services performed.

The Petitioners stayed on and rendered services to and through the entry of the Rehabilitation Order. They rendered those services in consideration for the promise of payment made in the Executive Employment Agreements. To paraphrase Corbin, cited above, the compensation promised is not a mere gratuity which can simply be withdrawn. It is a promise of payment in return for the rendering of services. Those services were unquestionably rendered and the payment is owing. Petitioners do not dispute that their claims are not Class 1 through 4 priorities. However, the claims are lawful and, as lawful claims, it is beyond question that the statute requires that these claims are to be paid prior to the Surplus Noteholders.

B. The Petitioners have properly asserted "Promissory Estoppel" Claims in the alternative.

The nonbinding Illinois case cited by Trapeza, In Re Liquidation of Security Cas Co., 127 Ill 2d 434; 537 NE2d 775, 782 (1989), is easily distinguished. In that case, shareholders sought the imposition of a constructive trust be imposed, claiming they had been fraudulently induced into purchasing the stock. The effect would have been to leap frog into a Class 1 Priority. The court refused to do so and found the statutory scheme of priorities had to be followed. Id, p.477. However, most importantly, the court did not disallow the claims because they were equitable, it merely refused to interpret them in such a way to elevate their priority.

The Michigan case referenced by Trapeza is equally off the mark. There, the court refused to apply equitable principals to alter the impact of the medical malpractice statute of limitations. As the court explained in Trentadue v Buckler Automatic Lawn Sprinkler Co., 479 Mich 378; 738 NW2d 664 (2007):

"As we clarified in *Devillers v Auto Club Ins Ass'n, 473 Mich 562, 590 n 65; 702 NW2d 539 (2005)*, however, our use of equity in *Bryant* is limited to those circumstances when the courts themselves have created confusion. In *Bryant,* the use of equity was appropriate because of "the preexisting jumble of convoluted case law through which the plaintiff was forced to navigate." *Devillers, supra at 590 n 65*. Here, in contrast, plaintiff has not detrimentally relied on confusing, pre-existing case law. By its very nature, the discovery rule does not lend itself to detrimental reliance; plaintiffs seeking to invoke it do not wait to bring suit because they expect to rely on the rule, but because they claim that external factors prevented them from discovering their claims." Supra, p. 406.

Neither of the cases cited by Trapeza stand for the proposition that an equitable claim is not a claim. Each case instead dealt with statutory procedures wherein the courts refused to be overruled by equitable arguments. Here, Petitioners are only seeking to assert a general claim under the theory of promissory estoppel within their rightful positions as a general creditor or "other claims." There is nothing in the statute voids equitable claims.

Finally, the Petitioners' claim for promissory estoppel is properly pled in the alternative.[2] The Petitioners worked at American Community under the terms of their Executive Employment Agreements through entry of the April 8, 2010 Stipulated Rehabilitation Order which terminated those contracts upon entry. As is evidenced by the payout of severance to Erickson and Walker, pursuant to the Court's December 11, 2011 Order, each of them could have at least assured themselves of significant severance by walking away, rather that working to and through the Rehabilitation. Had they not stayed, surely chaos would have reigned. However, they remained,

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[2]In alternative, if it is not, because Petitioners used standard "incorporation by reference" language at the beginning of the Count, Petitioners would seek the Court's leave to file amended pleadings so as to conform.

based upon the understanding that they would not be punished for staying on. Implicit in the silence was the promise by the Office of Financial and Insurance Regulation (OFIR) to compensate the Petitioners as they would have been under their Executive Employment Agreements. Thus, it was incumbent upon OFIR to advise the Petitioners that, if they stayed on until the Rehabilitation Order was entered, the Rehabilitator would refuse to honor their severance and/or Change in Control benefit rights.

C. The Court should interpret Chapter 81 as written, which is to recognize longstanding Michigan law and basic contract law that severance and other retention bonuses are enforceable because the Petitioners earned those benefits by rendering services prior to the Rehabilitation Order in satisfaction of American Community's promise to pay those benefits.

Trapeza has failed to offer a single circumstance where some other jurisdiction has ruled that a Rehabilitation does not constitute a Change in Control nor that similarly situated executives were denied contractual benefits upon entry of a Rehabilitation Order. This Court's obligation is to make the right decision pursuant to Michigan law under any circumstance. And, there being no decisions dealing with this subject, it is disingenuous to argue that a decision in favor of the Petitioners would "take Michigan out of sync." In light of basic contract law which controls the enforceability of these contracts, it is most likely that a decision in favor of Petitioners would, in fact, keep Michigan in sync with other jurisdictions.

Also, Trapeza's claim of a chilling affect on potential Surplus Noteholders is just plain silly. First, Surplus Noteholders are typically not even sought unless a company is suffering from some pretty dire financial issues, which is evidenced by the steep interest that is offered in return for the investment. Second, the risk to Surplus Noteholders is obvious, based upon the priority it is assigned in the event of liquidation.

Finally, rather than being an impediment to Surplus Noteholder investment, a decision favoring the Petitioners is just the opposite. Arguably, the reason there is any money left to pay the Trapeza and the other Surplus Noteholders is the job which these Petitioners did to preserve the value of American Community up to and through the Rehabilitation Order. They stayed based upon the inducements contained in their Executive Employment Agreements. Ruling in favor of the Petitioners will encourage good, continued corporate governance up to and through the rehabilitation process. In performing their due diligence in the future, Surplus Noteholders will be able to check if, in fact, the executives have these kind of benefits and then determine whether they are competently running the company. If so, it is to the Surplus Noteholders' benefit to keep them on at a premium. If not, bringing in a new team could be a warranted condition for the investment. Conversely, if Trapeza's position is adopted, competent executives working for distressed insurance companies will have no incentive to stay on and try to fix a troubled company, if they have no right to receive those benefits in the event their best efforts fail. If Trapeza's position is upheld, one could see competent executives resigning en masse upon investment by Surplus Noteholders because of the risk of losing their benefits. As a result, the distressed company would be unable to retain or obtain competent executives and it would assure the loss of investment by Surplus Noteholders, because no surplus would be left to distribute.

CONCLUSION

For all those reasons set forth herein, and in the companion Brief In Response to the Attorney General's Brief, Petitioners seek this Honorable Court grant them the relief sought in their Petitions.

Respectfully submitted,

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Dated: July 30, 2012

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COUZENS, LANSKY, FEALK, ELLIS, ROEDER & LAZAR, P.C.

EXHIBIT 1

Collateralized Debt Obligations

Updated: Oct. 19, 2011

Collateralized debt obligations, or CDOs, are created by banks that pool together otherwise unrelated debt-instruments, like bonds, and then sell shares of that pool to investors. During the housing boom, billions of dollars worth of mortgage-backed securities (themselves built on pools of individual mortgages) were pieced together into highly complex CDOs, producing billions of dollars of profits for banks but eventual losses for investors of tens of billions.

During the boom, most CDOs were divided into tranches, or levels, reflecting the estimated creditworthiness of the underlying debt. Investors received higher returns for the so-called equity tranche, which held the riskiest investments. As it turned out, the ratings of many if not most of CDOs proved to be overoptimistic.

During the later stages of the boom, banks began offering so-called synthetic CDOs. Instead of combining bonds, these combined credit default swaps written against specific bonds or pools of bonds. Credit default swaps were developed as a kind of insurance on financial instruments, albeit in an unregulated form. Essentially, one party swaps the risk of holding debt with another by paying a fee to that swapholder in return for a promise that a certain amount of money would be paid in case of default.

Investors buying a share of a synthetic CDO were essentially buying a bet for or against bonds owned by someone else. The nature of this format meant that two counterparties were required: one who thought the bonds would pay off and one who thought they wouldn't.

C.D.O. transactions are not publicly traded, so it is difficult to get a full picture of the market's size. But research suggests it was huge. Thomson Reuters estimates that sales of C.D.O.'s peaked at $534.2 billion in 2006, from $68.6 billion in 2000.

Since the market's collapse, the Securities and Exchange Commission has brought a number of cases against banks that it said created C.D.O.'s and sold them to investors without letting them know that the bank was betting that the deals would lose money.

Citigroup's Settlement

In October 2011, the S.E.C. announced that Citigroup had agreed to pay $285 million to settle charges that it misled investors in a $1 billion C.D.O. deal tied to the housing market, then bet against investors as the housing market began to show signs of distress.

The commission said that Citigroup exercised significant influence over the selection of $500 million of assets in the portfolio of the deal, known as Class V Funding III. Citigroup then took a short position against those mortgage-related assets, meaning that it stood to profit if they declined in value. The company did not disclose to the investors to whom it sold the C.D.O. that it had helped to select the assets or that it was betting against them.

Citigroup received fees of $34 million for structuring and marketing the transaction and realized net profits of at least $126 million from its short position. The $285 million settlement includes $160 million in disgorgement plus $30 million in prejudgment interest and a $95 million penalty, all of which will be returned to investors.

The company neither admitted nor denied the charges.

The Abacus Case

In April 2010, the Securities and Exchange Commission filed a lawsuit against Goldman Sachs charging that it had defrauded investors in a synthetic CDO by telling them the bonds involved had been selected by an independent manager when in fact they were selected by John Paulson, a hedge fund manager who made billions by betting that the real-estate bubble would collapse.

In July 2010 Goldman agreed to pay $550 million to settle federal claims that it misled investors, though it did not formally admit to the S.E.C.'s allegations. It acknowledged that the marketing materials for Abacus "contained incomplete information" and that it was "a mistake" not to have disclosed Mr. Paulson's role.

The Goldman case and the threat of more litigation represents the abrupt end to what was a golden era on Wall Street. The C.D.O. business has been a vital engine in the money machine at many firms for much of the last decade.

Big investors became addicted to the extra yield. Rating agencies earned windfall profits from evaluating the securities. Investment banks enjoyed hefty fees from ready buyers of the assets. And C.D.O. dealmakers racked up huge bonuses, regardless of whether their products later imploded.

Feeding the Boom

If the limitless appetite for these so-called structured products provided much of the easy money that fueled the housing boom, it also contributed to its bust. What began as a financial innovation lauding the benefits of diversified portfolios of corporate investments morphed into one giant bet on the American housing market.

To lure investors who wanted higher returns, bankers increasingly stuffed C.D.O.'s with riskier assets like subprime mortgage securities, rather than traditional corporate bonds. They bought their own mortgage companies to feed their loan packaging machines and relaxed the standards on the types of assets they would

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accept. Once the air started coming out of the housing market and there were no more mortgage bonds to sell, they created synthetic C.D.O.'s, whose supply was unlimited because they did not rely on hard assets.

C.D.O.'s are, in some ways, like mutual funds that hold bonds rather than stocks. But instead of selling shares, the creators of a C.D.O. sell slices, or tranches as they are known, that are linked to different securities in the underlying portfolio. A C.D.O. manager, working for either the bank or an outside investment management firm, typically picks those assets for a fee. Each C.D.O. slice is then rated by credit agencies for its potential risk, with more risky slices offering higher yields.

At the height of the housing boom, as interest rates dropped on competing investments like corporate bonds, big institutional investors like pension funds were tempted by these C.D.O.'s, which offered yields two or three times comparable investments but were marketed as "ultrasafe." But there was a catch. Top-rated tranches could hold mortgages and other shaky loans that were at risk of defaulting if the overall housing market weakened.

An ostensibly top-rated triple-A tranche might contain bottom-of-the-barrel subprime mortgage junk. That was supposed to make the tranche safer through diversification. In practice, however, it compounded the effect of a sharp, nationwide decline in home prices.

As homeowners began to default in ever greater numbers in 2007, the value of these C.D.O.'s collapsed.

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If Little Else, Banker's Trial May Show Wall St. Foolishness

By STEVEN M. DAVIDOFF

A midlevel former banker at Citigroup, Brian Stoker, is in court this week in connection with his role in creating exotic mortgage securities. While the civil trial is being hyped as a great exposé of Wall Street's role in the financial crisis, it may be something more banal, merely showing how clueless financiers can be. The problems started in late 2006 when bankers at Citigroup explored ways to profit from the C.D.O. craze. C.D.O.'s, or collateralized debt obligations, are complex securi...

July 18, 2012, Wednesday

MORE ON COLLATERALIZED DEBT OBLIGATIONS AND: CITIGROUP INC, STOKER, BRIAN H, COLLATERALIZED DEBT OBLIGATIONS, BANKING AND FINANCIAL INSTITUTIONS

An Investment Wipeout That Didn't Have to Happen

By GRETCHEN MORGENSON

An investor won an arbitration case over money lost in a complex security. But he's still angry at financial institutions.

February 05, 2012, Sunday

MORE ON COLLATERALIZED DEBT OBLIGATIONS AND: MERRILL LYNCH & CO, BANC OF AMERICA SECURITIES, HAYES, BOBBY L, ARBITRATION, CONCILIATION AND MEDIATION, BANKING AND FINANCIAL INSTITUTIONS, FINANCIAL BROKERS, COLLATERALIZED DEBT OBLIGATIONS

U.S. Expected To Charge Ex-Traders With Fraud

By PETER LATTMAN

Federal prosecutors are preparing to file criminal charges against former traders at Credit Suisse, accusing them of defrauding investors by mispricing mortgage securities, according to a person with direct knowledge of the matter. Charges could be filed as soon as Wednesday, said this person, who requested anonymity because he was not authorized to discuss the case publicly. It is unclear how many traders will be charged.

February 01, 2012, Wednesday

MORE ON COLLATERALIZED DEBT OBLIGATIONS AND: CREDIT SUISSE GROUP A.G, SUBPRIME MORTGAGE CRISIS, BANKING AND FINANCIAL INSTITUTIONS, COLLATERALIZED DEBT OBLIGATIONS, MORTGAGE-BACKED SECURITIES

Did You Hear the One About the Bankers?

By THOMAS L. FRIEDMAN

While the world watched the demise of Qaddafi, some unsettling news from Wall Street helped explain why all those protests are resonating.

October 30, 2011, Sunday

MORE ON COLLATERALIZED DEBT OBLIGATIONS AND: CITIGROUP INC, SECURITIES AND EXCHANGE COMMISSION, SENATE, HOUSE OF REPRESENTATIVES, GOLDMAN SACHS GROUP INC, SUBPRIME MORTGAGE CRISIS, UNITED STATES POLITICS AND GOVERNMENT, BANKING AND FINANCIAL INSTITUTIONS, MORTGAGE-BACKED SECURITIES, LOBBYING AND LOBBYISTS, CAMPAIGN FINANCE

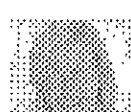
Conflict of Interest

By BEN PROTESS, AZAM AHMED and MICHAEL J. de la MERCED

Regulators are moving ahead with a plan to rein in conflicts of interest in the securitization market. The proposed rule, unveiled on Monday by the Securities and Exchange Commission, would prohibit banks and other financial firms from both sponsoring asset-backed securities and betting against the deals. The S.E.C. also would crack down on practices that a "reasonable" investor would consider a conflict of interest. The rule would have covered deals by both Goldman Sachs and JPMorgan Cha...

September 20, 2011, Tuesday

5 Wisconsin School Districts and 3 Ill-Fated Securities



By GRETCHEN MORGENSON

The lawsuits have been flying after five Wisconsin school districts lost millions of dollars in complex debt securities.